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ADVANCE LETTER ON GENERAL BUSINESS CONDITIONS

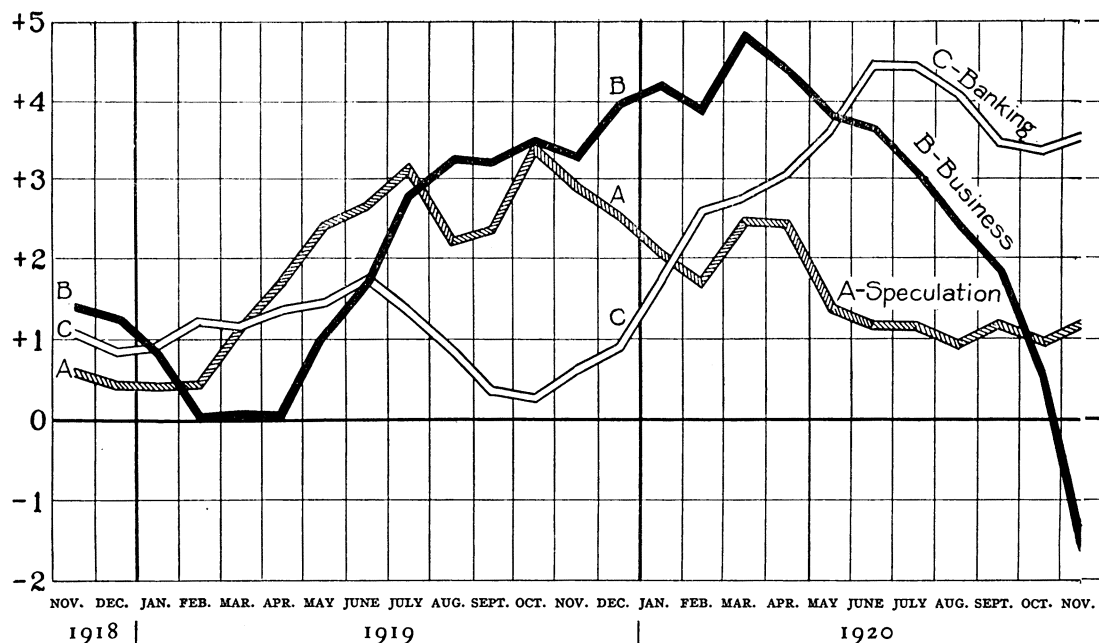
December 15, 1920

(THE DATE REFERS TO THE DAY OF FINAL REVISION)

IN November, curve B, representing business, declined even more sharply than in October, when all previous records were broken. This change is due to a fall in both of the series on which the curve is based, but especially to the extraordinary recession in wholesale prices. *Bradstreet's* index number for December 1 was

ities, marked recessions in security prices, and probably another heavy crop of business failures.

Evidences of approaching business revival are not yet apparent in the news of the day, nor do we expect to see any very soon. There are considerations, however, which support the forecast drawn from our Index Chart



INDEX CHART. The items locating curves A, B, and C all refer to *complete calendar months* and the points are plotted in the middle of the spaces allotted to the months.

EXPLANATION: Each of the three curves on the Index Chart is obtained by averaging a group of statistical series, each group being composed of series homogeneous in character; i.e., when corrected for the seasonal influence and normal growth, the series of each group move in the same direction (upward or downward) at the same time. The series were all expressed in comparable units before averages were taken.

Our interpretation of the fluctuations of the three curves of the current index chart is based upon the relationship which was discovered among similar curves for the period 1903-14. All three curves had wave movements, but the upward swings and the crests of the waves were not reached simultaneously. The major movements of speculation preceded those of business by 4 to 10 months, and the movements of business preceded those of banking by 2 to 8 months. The sequence of movements holding for upward swings and crests also held for downward swings and troughs.

The relationship between the curves which held for the pre-war period appears to have reestablished itself in 1919 so that the movements of the curves constitute a basis for forecasting. Our forecasts, however, are not based solely upon the index of general business conditions, but they allow for the differences in underlying conditions as revealed by economic analysis.

The rise of curve A, representing speculation, between February and

October 1919 forecasted the rise of curve B, representing business, which took place between April 1919 and March 1920. Low interest rates, curve C, facilitated expansion of both speculation and business until the federal reserve banks, in November 1919, inaugurated their policy of increasing rediscount rates.

The persistent decline of curve A and the equally persistent rise of curve C, both movements beginning in November 1919, forecasted that a decline of business activity and commodity prices, curve B, would be inaugurated in the spring of 1920. In fact business unsettlement was noticeable in April and it has increased since that month while various indices of commodity prices have receded since May. The existence of the federal reserve system and the action of the banks in increasing rates and restricting credit made it appear very unlikely that the business readjustment indicated by the index chart would be accompanied by a financial panic. At this writing, we have passed the time in the business cycle when a financial panic would have occurred, if we were to have one.

Finally, the decline of curve C and the horizontal movement of curve A, both beginning in July 1920, indicate that the recession of business, curve B, now in progress will end in April 1921. The immediate prospect for the winter of 1920-21 is unsettled business, an easier money market, and increasing security prices.

\$13.63, being 13 per cent below that for November 1. This brings wholesale prices more than half way down to the level of August 1914.

This tremendous readjustment was accomplished without a financial breakdown, and indeed, without any impairment in the condition of the country's central institutions of credit. Despite this showing of strength, however, the business situation in December continued critical. At this writing it appears likely that many business men must secure from their banks the funds needed for tax payments due on December 15, and the losses recorded in balance sheets make bankers reluctant to extend the accommodation in some cases. It is not strange, therefore, that December has brought continued credit stringency, further liquidation of commod-

that a revival of business will begin next spring: one being the fact that a number of important raw materials, such as cotton, wool, and leather, are selling much below recent costs of production and probably below the costs that will rule next year even with considerably reduced wages; another being the fact that the physical production in both mining and manufacture was less in 1919 and 1920 than in 1916, 1917, or 1918. Both of these considerations support the forecast that there will be a recovery in some prices at no distant date.

Our conclusion that production was not unusually great in the past two years is based upon the indices of the physical volume of production for agriculture, mining, and manufacture which have been published in recent numbers of the REVIEW and upon the prelimi-

nary indices which we have computed for 1920. The figures are given in the following table:

INDICES OF PHYSICAL PRODUCTION, 1916-20

(Average for 1909-13 = 100)

	1916	1917	1918	1919	1920
Agriculture	100.4	108.5	107.1	110.6	115
Mining	129.5	134.5	135.6	110.8	126*
Manufacture	127.7	125.6	125.0	114.0	118*
Combined Index †	117.2	119.8	119.0	112.5	118

* Based on returns for 9 months increased by one-third.

† The three constituent indices are weighted according to values in 1909.

BUSINESS

The volume of business, as measured by bank clearings outside New York City, which in the past generally decreased about 2 per cent in November, was this year $8\frac{1}{2}$ per cent below the October figure. The decline has continued during the first half of December. The districts which made the poorest showing were, it is evident from the accompanying table, those most affected by the sluggish marketing of the crops.

OUTSIDE CLEARINGS

(Unit: \$1,000,000)

	September	October	November	Ratio of Nov. to Oct.
Middle *	3,783	3,996	3,703	92.7
New England	1,664	1,804	1,695	94.0
Middle West	4,864	4,984	4,479	89.9
Pacific	1,784	1,814	1,706	94.0
Other West	2,417	2,440	2,206	90.4
Southern	2,877	3,070	2,782	90.6
Total	17,389	18,108	16,571	91.5

* Excluding New York City.

The fall of wholesale prices has recently shown some evidence of slowing up, though the trend is still downward. The number of declines recorded in Dun's list has decreased for two successive weeks, while the number of advances has increased slightly. Moreover, the tone of certain markets is more cheerful. The non-ferrous metals appears to be emerging from the extreme depression of November, and much the same may be said of dry goods, clothing, and leather. The grains, although giving fitful indications of strength, are still under the shadow of impending liquidation of the large stocks known to be in the hands of farmers.

Perhaps the principal factor underlying this change in sentiment is the belief that in important lines there is an accumulation of unsatisfied demand, which only awaits evidence of price stabilization to make itself felt. It is pointed out, for example, that during the last five years the consumption of steel rails in this country has been about 30 per cent below normal; that building operations have been almost at a standstill of late; and that people cannot go threadbare forever. Although the expectations founded on this reasoning may prove to be exaggerated, we believe that they are in general justified; and therefore we expect no long period of depression at the end of the present period of liquidation.

Another encouraging feature of the situation — one that usually begins to develop towards the end of a

period of depression — is an increase in operating efficiency, which helps producers to bring prices down to the rock-bottom levels demanded by close buyers. Typical of current reports along this line is the statement of a large manufacturer that production in his plant had increased over 10 per cent with a working force actually smaller.

SPECULATION

The recovery in security prices which developed late in November proved not to be a sustained revival, and many stocks have since fallen to new low levels. Our average of ten gilt-edged railroad bonds, however, was higher in November than in October. Bond prices have declined recently as shown by Dow, Jones & Co.'s average for 40 bonds, which fell about $2\frac{1}{4}$ points in November and about $1\frac{1}{2}$ points between November 30 and December 11. To the depressing effect of tight money is now added selling for tax purposes — either to establish losses or to obtain funds for tax payments — while the present business situation still offers little or no tangible basis for a reversal of the speculative movement. Moreover, the depression in agricultural products has curtailed the buying power of a fairly important group of investors. With tax day and end-of-the-year financing out of the way conditions should be more favorable for sustained recovery in security prices.

BANKING

Actual rates on commercial paper have not changed during the past two weeks. Funds have not been as plentiful in the call and time loan markets, and it is expected that money rates will be run up temporarily by the demand for tax payments.

The improved condition of the combined federal reserve banks at the end of November has been maintained during the first half of December. Between December 3 and 10 total bills on hand fell 58 million dollars and net deposits 5 millions, federal reserve notes were unchanged, while total reserves increased 14.2 millions and the ratio of reserves to liabilities increased from 44.1 to 44.5 per cent. This is a very satisfactory statement for the last week before the December income tax payments. Next week's statement should show still greater improvement. The reserve ratios of the various federal reserve banks, adjusted for inter-district loans, show marked improvement since November 26 in Philadelphia, Richmond, Minneapolis, and St. Louis. Dallas, Atlanta, and Kansas City have the lowest reserve ratios in the system, while Cleveland, Philadelphia, and Boston have the largest ratios. The statement of the condition of 823 member banks in leading cities for December 3 shows further liquidation of all classes of loans, accompanied by large reductions in demand deposits and continued increase in borrowings from the federal reserve banks.

The large volume of funds still tied up in slow agricultural loans and in advances to exporters who have been embarrassed by conditions in foreign markets is giving bankers serious concern, and various plans for relief are under discussion in Congress and by bankers.